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FM AMEMBASSY BISHKEK

TO RUEHC/SECSTATE WASHDC 1852

INFO RUCNCLS/ALL SOUTH AND CENTRAL ASIA COLLECTIVE

RUCNCIS/CIS COLLECTIVE

RUEHBJ/AMEMBASSY BEIJING 2905

RHEFDIA/DIA WASHDC

RUEKJCS/OSD WASHDC

RUEAIIA/CIA WASHDC

RHEHNSC/NSC WASHDC

RUEKJCS/SECDEF WASHDC

RUEKJCS/JOINT STAFF WASHDC

RUEHGV/USMISSION GENEVA 1261

RUEHVEN/USMISSION USOSCE 3302

RUCNDT/USMISSION USUN NEW YORK 2688

RUEHNO/USMISSION USNATO BRUSSELS BE

RUEHBS/USEU BRUSSELS

RUEHLMC/MILLENNIUM CHALLENGE CORP

RUMICEA/USCENTCOM INTEL CEN MACDILL AFB FL

C O N F I D E N T I A L SECTION 01 OF 03 BISHKEK 000170

SIPDIS

DEPT FOR SCA/CEN (GORKOWSKI)

E.O. 12958: DECL: 02/26/2019

TAGS: PREL ECON PGOV EFIN KG

SUBJECT: BENEFICIARIES OF RUSSIAN AID TO THE KYRGYZ REPUBLIC

REF: A. BISHKEK 108

1B. BISHKEK 144

1C. BISHKEK 152

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Classified By: Amb. Tatiana Gfoeller, Reason 1.4 (b) and (d).

11. (C) Summary: In early February, Russian President Medvedev pledged a \$150 million grant, forgiveness of \$193 million in Kyrgyz debt (in exchange for a 48% stake in a military goods manufacturer), a \$300 million low interest loan and \$1.7 billion in financing for a Soviet-era hydroelectric project to Kyrgyz President Bakiyev. Kyrgyz officials have taken all necessary steps to authorize receipt of these funds, but attention is now focused on whether these funds will actually materialize and how they will be utilized. There are concerns that, even if Russia delivers on the promised assistance, the funds will disappear through corruption, pet projects, and spending related to President Bakiyev's expected 2009 reelection campaign. In addition, the hydroelectric project would grant Russia de facto control of upstream water resources, and increase Russian influence over the release of water downstream to Uzbekistan -- a constant source of irritation between Tashkent and Bishkek. Despite the elimination of existing bilateral debt, the Russian package, if implemented, could expand the Kyrgyz Republic's net debt burden by at least \$1 billion if the mostly Kyrgyz state-owned joint venture partner is unable to offload this debt. End summary.

Dollar Signs

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12. (U) On February 4 in Moscow, Russian President Dmitry Medvedev pledged \$2.3 billion in bilateral financial aid, loans and debt forgiveness to Kyrgyz President Kurmanbek Bakiyev. Specifically, the pledge included a \$150 million grant; elimination of Kyrgyz debt to Russia (amounting to about \$193 million as of January 2009) in return for an additional 48% stake in the Dastan Open Joint Stock Company (a manufacturer of military equipment) and the building housing the Russian trade office in Bishkek; a \$300 million

low interest rate loan; and a \$1.7 billion higher interest rate loan targeted for the construction of the Kambarata 1 hydroelectric station. The Russian pledge coincided with Bakiyev's public announcement of his decision to close the U.S.-operated multinational Manas Air Base near Bishkek that supports Operation Enduring Freedom in Afghanistan.

Public and Private Plans

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¶3. (SBU) By February 10, Kyrgyz authorities had implemented the necessary legislative and executive actions to accept the Russian package. Based on public information, it appears that Kyrgyz officials expect the \$150 million grant and \$300 million loan to be transferred to Bishkek by April 30. Kyrgyz Prime Minister Igor Chudinov stated February 5 that the \$150 million would be a dedicated "reserve for the country," which would be utilized to "fulfill social obligations" for citizens in case of a deterioration of the Kyrgyz Republic's economic situation. In reality, the Kyrgyz Republic is already facing economic challenges (refs B and C), which might merit use of these funds to cover a growing government budget deficit. Chudinov added that the Kyrgyz government would be flexible in determining how to allocate the \$300 million, but hinted at possible use in infrastructure or commercial projects.

¶4. (C) These public pronouncements, however, may not reflect the intended use of the Russian funds. The local International Monetary Fund representative confirmed to Emboff February 17 that existing internal Kyrgyz Ministry of Finance mechanisms are inadequate to track the distribution of Russian funds once deposited in the Kyrgyz Central Bank.

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(Note: There have been long-standing allegations of significant corruption within senior ranks of the Ministry of Finance. End note.) In a February 11 news conference, President Bakiyev announced his intention to run for reelection, and suggested that the Constitutional Court decide whether the election should take place in 2009 or ¶2010. If, as expected, the Constitutional Court determines that elections should take place in 2009 and the Russian funds arrive as promised, President Bakiyev would have access to up to \$450 million to spend to secure reelection. (See Ref A for more discussion of Bakiyev's reelection spending plans. End note.)

Who's in Charge of Kyrgyz Hydropower?

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¶5. (SBU) The \$1.7 billion loan is aimed at building the Kambarata 1 dam and hydropower station. The Kyrgyz Republic will continue self-financing construction of the smaller, adjacent Kambarata 2 station. (Note: The Kambarata project originated in the Soviet era and was mothballed, after minimal construction, after the Soviet Union's collapse. The designs have reportedly not been updated since the 1980s, and experts have questioned the commercial viability of the projects. End note.)

¶6. (SBU) While President Medvedev pledged the loan to the Kyrgyz Republic, subsequent statements by Kyrgyz officials, such as Minister of Finance Sultanov, have qualified the lending as being extended to a joint stock company to be owned equally by Russian electricity giant Inter RAO UES and the mostly state-owned Kyrgyz Electric Stations company. (Note: This distinction could be significant if there is later disagreement over which party is obligated to repay the loan. If the mostly state-owned Kyrgyz partner is not able to offload the debt, then the burden would likely fall to the Kyrgyz government. End note.) The joint stock company's board of directors will have a majority appointed by the Russian side, and be headed by a Russian appointee. (Note: The Russian government appears to be the largest shareholder in Inter RAO UES. End note.) Embassy contacts have also

suggested that the Russians might "buy out" the Kyrgyz partner and gain total control over the project.

¶7. (C) Given Uzbekistan's disagreements with the Kyrgyz Republic over the timing of water releases from the Kyrgyz Toktogul hydroelectric cascade, control of Kyrgyz water supplies and electricity generation is a sensitive regional topic. Nearly 80% of Kyrgyz hydroelectric power is currently generated in the Toktogul cascade. However, the Kambarata project is upstream of the Toktogul cascade, and would control the availability of water to the Toktogul reservoir. If the Kambarata project is implemented as planned, the Russian side would have significant leverage in determining Kyrgyz hydropower generation and releases of water downstream to Uzbekistan. A limiting factor, however, is that the Kambarata reservoir (which would rest behind Kambarata 1) has a planned capacity of 4.6 billion cubic meters, whereas the Toktogul reservoir can store up to 19 billion cubic meters. But, filling the Kambarata reservoir would withhold water from the Toktogul reservoir.

Comment

¶8. (C) While Kyrgyz officials are enamored with the potential influx of Russian funds, some opposition politicians have cautioned that the Russian package will signify the loss of the Kyrgyz Republic's independence. Other local observers question whether the Russians can currently afford such largesse, and whether they intend to fulfill their pledges. If the Russian money materializes, it could help the Kyrgyz Republic bridge some of its short-term fiscal challenges, but these funds could alternately be

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squandered on reelection campaigning, pet projects, or simply be pocketed by senior officials. The prospects of Russian dominance of hydroelectric power and water supplies should trouble local leaders, who appear instead to value short-term benefits over the dangers of growing dependence on Moscow.

GFOELLER